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King: Recent Tax Developments and Issues Affecting Canada-United States

Recent Tax Developments And Issues Affecting Canada-United States Transnational Business Operations

Introductory Remarks

*Henry T. King, Jr., Chief Corporate International Counsel, TRW Corp.,
Cleveland.*

THIS AFTERNOON WE will deal with recent tax developments and issues affecting Canada-United States transnational business activities. We have three speakers; two of whom are from Canada and one from the United States. Each of these men are extremely qualified in terms of their background and the subject for this afternoon's discussion.

First, a word about United States-Canada involvement. Canada is the leading trading partner of the United States and more American goods are exported to Canada than to any other area in the world. United States investment is particularly heavy in Canada and in many industries it is predominant. In fact, in 1975, over twenty-five percent of all United States direct foreign investment excluding petroleum investment is in Canada and this has section 482 and section 861 implications from an American tax standpoint. Section 482 deals with allocations of income and deductions between related companies. Section 861 deals with allocation expenses against foreign income for the purpose of determining foreign taxes which can be applied against United States taxes. It also means that there would be considerable impact on American firms in the event that the deferral provisions of the United States Internal Revenue Code were eliminated. At the same time, United States exports to Canada, as distinct from investment, are particularly heavy, especially from the Cleveland area where exports of auto parts are quite substantial. It's far greater than any other area of the world.

Now, in terms of the broad strokes, and again as part of the setting in which our speakers will talk today, there are two developments which are of particular interest. One is the tendency of Canada in the early 1970's to flex its muscles and seek to review United States investments and activities in Canada from the standpoint of its own national interest. And the second is the tendency of the United States tax authorities to examine, in the objective sense, the relationship between United States parents and their Canadian subsidiaries. In the not too distant past in many American firms, there had been a tendency to view Canadian subsidiaries as, in effect, branches of American firms and to deal with them organizationally on that basis. Now, there is a tendency to treat Canadian subsidiaries as separate and distinct entities and to view them as such for tax purposes as well. This development will be reflected in the comments of our speakers this afternoon.

So much for the backdrop. We have three speakers. I think it's best to identify them in terms of what they will talk about rather than to interrupt

the sequence of their appearances. Robert Brown, on my left, resident partner for Price Waterhouse & Co., Toronto, Canada, is going to cover several areas. These include the new Canadian legislation affecting corporate reorganization; the new designated surplus and dividend concepts in Canada as a result of the 1977 Income Tax Act and changes in the corporation laws that facilitate reorganization previously barred by recent incompatibility between provincial and federal statutes. In conjunction with this, Bob also will talk about anti-avoidance measures which have just been passed in Canada. This is an entirely new development and it will involve a review of the tax aspects of the takeover rule. Third, Bob Brown will talk about the Foreign Investment Review Agency which is charged with reviewing new American and other foreign investments in Canada in terms of whether they represent a significant benefit to Canada, including the purchase by non-Canadian companies, and new activities by existing United States owned and other foreign owned firms. Bob also will cover attitudes in Ottawa concerning foreign takeovers, *i.e.*, the agreements being extracted from foreign firms in the role of preventing such takeovers. Finally, Bob Brown will have a few comments on the proposed end of deferral as seen from the Canadian standpoint. Personally, it is a privilege to appear with Bob on this platform as I have had the pleasure of working with him at the International Tax Conference sponsored by the *London Times* in Honolulu last winter.

A second speaker on my right here, is George Goodrich. George is a partner, a tax partner, at Arthur Andersen & Co., here in Cleveland. He is going to focus on some developments which seem to be breaking new ground internationally, including United States-Canada joint tax audits which have just been announced and are now getting underway. George also will deal with United States-Canada competent authority proceedings which are moving ahead faster than competent authority activities in other areas and which, from an American standpoint, are primarily based on section 482 of the Internal Revenue Code. George also is going to cover the impact of the new section 861 regulations on the Canadian operations of United States companies. Finally, George will focus on the role of Canadian operations in light of these section 861 regulations.*

* Mr. Goodrich's remarks at the Workshop were unable to be reprinted due to technical difficulties.